BRIEF IN SUPPORT OF THE PETITION.

1. The Decision Below is in Conflict with Decisions in Other Circuit Courts of Appeals.

In *Farmers & Merchants Bank of Catlettsburg, Ky.*, v. *Commissioner*, 59 Fed. (2d) 912 (C.C.A. 6), the bank received an amount in full settlement of a case against the Federal Reserve Bank of Cleveland in a lawsuit for damages for permanent injury to its standing, growth, and prosperity because of the malicious practices of the Reserve Bank in hampering and embarrassing it in the conduct of its affairs. This recovery was held not to constitute taxable income, the court saying:

> "We think that, if the petitioner's case had proceeded to a verdict, the law would not have awarded to it what it might have expected to gain but only that which it had actually lost . . . We think therefore that there is no logical basis upon which petitioner could be charged with gain . . . One may be recompensed for an injury, but it is a rare case in which one should have a profit out of it."

This case is exactly in point. Both cases involved a recovery for tortious injury to the business good will, and there is nothing in the *Merchants Bank* case to indicate that there was any showing of the cost or basis of the good will injured or from which it could be inferred that any cost or basis could have been established.

In *Central R. Co. of New Jersey* v. *Commissioner*, 79 Fed. (2d) 697 (C.C.A. 3), property worth $465,405 was received in settlement of a suit against the plaintiff's officer and a corporation formed for him for damages sustained in entering into contracts and agreements with

corporations which the officer surreptitiously controlled. The recovery was held not to constitute taxable income by analogy to alimony and damages for alienation of affections, breach of promise, libel, and slander.

> "Those actions are of a personal nature and do not fall within the statutory definition of income. The thought is that a recovery in such actions is compensatory . . . It is apparent then that income must come from capital or labor or both, including gains on the sale of assets. That being so, the value of the property which the taxpayer received cannot be traced to either capital or labor . . . It cannot be said that it was derived wholly or in part from the use of the taxpayer's capital or labor. The nearest that one can come to that is to say that Joyce and his dummies could not have operated but for Joyce's position with the taxpayer and its type of business. But Joyce's ultra vires operations were not carried on by the use of the taxpayer's capital and labor. They were entirely separate and apart from its business structure."

This case is also squarely in conflict with the decision below. Both of these cases, however, are consistent with the decisions of this Court next referred to.[1]

2. The Decision Below is in Conflict with Principles Announced by This Court.

In *Eisner* v. *Macomber*, 252 U.S. 189, the Court, developing its prior decisions in *Stratton's Independence* v.

[1] See also *Edward N. Clark*, 40 B.T.A. 333; *Highland Farms Corporation*, 42 B.T.A. 1309.

Howbert, 231 U.S. 399, 415 and *Doyle* v. *Mitchell Bros. Co.*, 247 U.S. 179, 185, laid down a definition of income to which it has adhered in many subsequent decisions, viz.:

> "'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets."

It is submitted that the recovery in question in this case does not fall within the foregoing definition.

In *Bowers* v. *Kerbaugh-Empire Co.*, 271 U.S. 170, it was decided that, where the taxpayer repaid to the Alien Property Custodian a loan from a German bank on the basis of 2½ cents per mark, no income was derived. Per Butler, J.:

> "The loss was less than it would have been if marks had not declined in value; but the mere diminution of loss is not gain, profit or income."

It is submitted that the recovery in the case under consideration was a mere diminution of loss.

United States v. *Safety Car Heating Co.*, 297 U.S. 88: In this case it was decided that the recovery of amounts received in 1925 in settlement of a suit for profits made in 1912 was taxable. For the purposes of our case what is important are the statements of Cardozo, J., at page 93:

> "Congress intended, with exceptions not now important, to lay a tax upon the proceeds of claims or choses in action for the recovery of profits . . ."—

and at page 98:

> "The case is not to be confused with one where the basis of the suit is an injury to capital, with the result

that the recovery is never income, no matter when collected."

The decision below is in conflict with the quoted statements.

Respectfully submitted,

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